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FORTUNE

THE INSIDE STORY OF WARREN BUFFETT

The legendary investor is also an ace at running esses. Here's he does it.

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APRIL 11, 1988 VOL. 117, NO. 8

FORTUNE

"I want to be in businesses so good that even a dummy can make money."

PAGE 26

"The key to managing 600 volunteers was to help them gain skills that made their efforts more personally rewarding."

PAGE 42

"They view him as Darth Vader. No matter what this man does, he is perceived as being up to no good."

PAGE 65

"Department stores have been charging customers more and giving them less. That is not a sure-fire formula for success."

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"Personally, he's tight. But he spends our money prodigiously."

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"I figure out what's fair, and then I double or halve any numbers and start from there."

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Cover: Warren Buffett holds a bridge hand at the Manhattan apartment of Washington Post Co. Chairman Katharine Graham. Photo by Louis Psihoyos.

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THE EDITOR'S DESK

LOUIS PSIHOYOS

At the table with writer Loomis, Buffett demonstrates "the strongest part of my game."

JOURNALISTS, it has been said, should not have friends. Being human, we do. In the cover story beginning on page 26, you will be treated to an article that is a product of a friendship between the subject, famed investor Warren Buffett, and the writer, Carol Loomis, of our board of editors.

Loomis and Buffett met in the mid-1960s through her husband, John, then an institutional salesman for a Wall Street firm. After reading a small item about this man Buffett, who was 35 at the time and just beginning to gain a national reputation, John called on him in Omaha, hoping to drum up trading orders. On returning to New York, John told Carol, "I think I have just met the smartest man in the country." Since then, Carol says, "neither of us has found reason to revise that appraisal."

One interest the Loomises and Buffett share is bridge, and when he comes to New York for board meetings, they often play at the apartment of the Washington *Post*'s Katharine Graham, who is a friend of all. Says Carol: "I regret to report that over the years he's won more often than we have." Listen, Carol, take a look at the picture and maybe you'll see why.

For ten years Carol has worked with Buffett on his witty and wise annual report. Says she: "Warren writes it by hand on yellow pads. I weigh in as editor. He's smart enough to know that everyone needs an editor, though sometimes I could kill him for ignoring my suggestions. Anyway, what I do on the report a lot of people who know something about both business and writing could do, as long as they had Warren's trust. What *he* does, nobody else could come close to doing."

Until now Carol has refrained from writing a full-scale article on Buffett, both because of their friendship and because of the fact that she is a shareholder in his company, Berkshire Hathaway. I got to thinking that her reticence was robbing our readers and prevailed upon her to step up to the job. She had the insight to see that Buffett's success as a manager was an unreported phenomenon, and her story is filled with facts about him not before printed. I think that, upon reading this unusual "inside" article, you will be glad I persuaded her to write it.

Marshall Loeb

MANAGING EDITOR

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WHERE WILL WE PUT

Not in my neighborhood, says a rising chorus of citizens who don't like landfills and incinerators. Now that disposal costs are rocketing, more recycling is inevitable. ■ *by Faye Rice*

BARGES FORLORNLY roaming the seas in search of a place to unload are suddenly the stuff of headlines. The U.S., whose seemingly infinite dumping space helped foster history's biggest throwaway binge, is running out of places to put its trash. The immense and growing volume—200 million tons a year of household and commercial refuse, plus untold industrial waste—would have spelled trouble sooner or later. The crisis is already here because states and localities, newly concerned about water contamination, methane gas leaks, and sheer unsightliness, have taken to wholesale closing of dump sites.

Nationwide, the number of landfills has dropped from an estimated 10,000 in 1980 to 6,500. One study indicates that all but four states are running out of suitable locations. Landfills in Connecticut will be nearly full by 1990, those in the Los Angeles area by 1993. Incinerators have hardly dented the problem. Widely hailed as the answer a few years ago, many are running into a hornet's nest of resistance from environmentalists and community groups. Instead of burning trash, opponents say, the U.S. should follow the lead of Japan and Europe, where recycling drastically cuts the tonnage that must be disposed of.

The solutions to the growing mess, which include recycling as well as burning under carefully controlled conditions, will not be cheap. So steeply has the cost of dumping climbed, however, that the alternatives have begun to look cheaper. In Philadelphia, disposal costs per ton have nearly tripled since 1983. In New Jersey, half of all household waste is now trucked to out-of-state landfills up to 500 miles away. Despite a tough new recycling law that has reduced the total volume, annual collection and dumping costs for a household in suburban Union County near New York City have leaped from $70 to $420 just in the past 12 months.

Those costs, passed along in the form of higher taxes or fees paid to private sanitation firms, are causing howls of pain throughout the Garden State. In some low-income neighborhoods, trash is piling up on sidewalks because homeowners cannot afford the skyrocketing fees. Already, the idea of paying for waste disposal by the bag—with sanitation men loading only bags affixed with stamps purchased in advance—is being considered as a way to distribute the costs fairly. The less you toss, the less you pay.

Across the nation, the torrent of waste has run smack up against the mind-set known as NIMBY—Not in My Back Yard. Establishing a new landfill arouses stiff local opposition. Shipping trash across state lines to existing sites has become a lucrative business for truckers, but the mood in communities at the receiving end is not hospitable. About 200 demonstrators carrying colorful placards de-

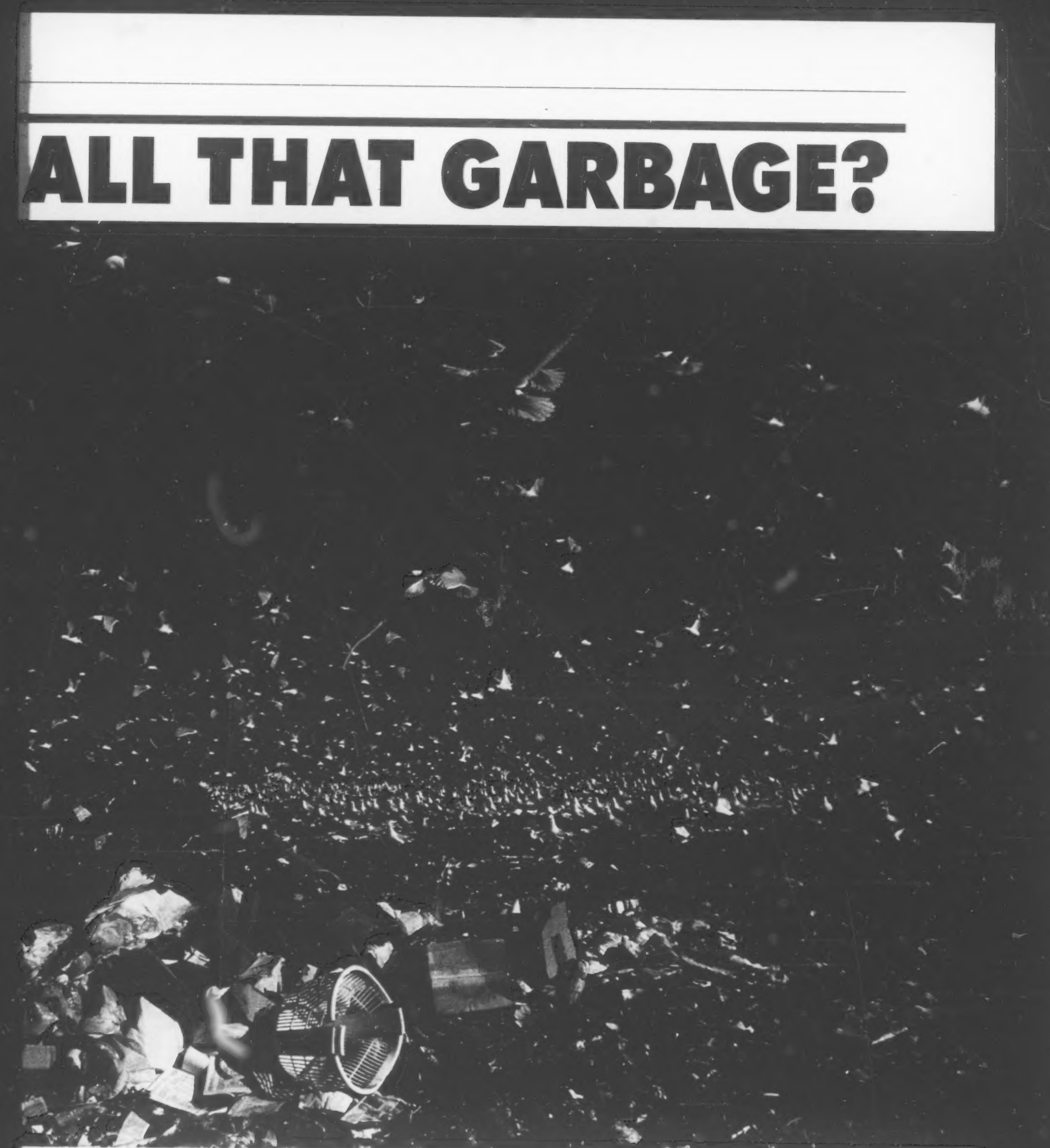
REPORTER ASSOCIATE *H. John Steinbreder*

Dumped on: *West Virginians protest at the state capitol against incoming Northeastern trash.*

In a nightmarish scene *worthy of Hitchcock, gulls*

PHOTOGRAPH BY NINA BARNETT

ALL THAT GARBAGE?



t at New York City's huge Fresh Kills landfill on Staten Island. One of two remaining landfills in the city, it handles 25,000 tons of garbage daily.

LOOKING AHEAD

claring WAR ON OUT-OF-STATE WASTE, gathered at the capitol steps in Charleston, West Virginia, several weeks ago to protest the trucks that arrive daily from the Northeast to disgorge their loads. The message: "We're desperate to find a solution before it's too late." In the retirement community of Zip City, Alabama (population: 600), citizens who live off Social Security checks are trying to stonewall a proposed landfill for trash from out of state, which would obliterate 225 acres of rolling pasture.

When state and local governments do allow new landfills, they are becoming fussy about their operation. As the trash piles grow, it is customary to cover them with layers of topsoil. But in Pennsylvania, landfill operators must also line new dumps with such watertight materials as clay or thick polyethylene, and install drainage systems to test and treat whatever oozes through these barriers before it can taint ground water. Concerned civic groups assert that the landfills all leak. "There is no such thing as an impermeable liner," concedes Roger Carrier, vice president of engineering at Chambers Development of Pittsburgh, a fast-growing landfill operator. He argues that the real issue is the *rate* of leakage. "If it is fast you're in trouble, but if it is slow it evaporates before it can become a problem."

MIKE CLEMMER—PICTURE GROUP

Interstate trash traffic *is spreading in the South, where a truck crosses into Alabama.*

The NIMBY wrath has come down hardest on proposed new incinerators designed to alleviate the landfill shortage. The plants, employing the "mass burn" technique developed in Europe, convert garbage to energy. To hold down costs, incinerator operators do not bother with the costly mechanical separation of materials that doomed another type of U.S. plant. Except for a few bulky or dangerous items culled from the incoming trash, everything is burned without sorting, to produce steam and electricity.

ABOUT 40 mass-burn incinerators are operating and 200 more are under construction or planned. New York City wants to build one in each of its five boroughs, at a total estimated cost of $3 billion. But fierce opposition is widespread. Inner-city blacks and white professionals formed an unlikely alliance in Los Angeles and forced Mayor Tom Bradley to shelve his proposal for three mass-burn facilities. Two of the mayor's choices for city council seats lost in last spring's election, partly because they supported incinerators. "I don't think we will see an incinerator in the Los Angeles area for at least ten years," says Michael Miller, manager of the city's solid waste task force.

Philadelphia owns two old incinerators that nearby neighbors have campaigned for 20 years to shut down. Mayor W. Wilson Goode's answer is to add a giant new $350 million mass-burn facility. In his successful reelection bid last year, Goode urged voters to oust David Cohen, a city council veteran who opposes the burner. Cohen got the biggest victory vote of his career.

Incinerator fighters point to potential air and water pollution, as well as the noise and increased traffic from trucks delivering trash. Unless the fire is kept above a certain temperature, household items such as some solvents and plastics can produce highly toxic chemicals called dioxins, which are carried up through the smokestack.

Incinerators drastically shrink the garbage delivered to them—up to 90% by volume and 75% by weight—but leave millions of tons of ash that must be buried. Toxic metals such as lead and mercury are more concentrated in the ash than in the original garbage, and can seep into ground water from poorly sealed disposal sites.

So far the environmental record of mass-burn incinerators has been mixed, with some objectionable practices but no serious health scares. The economics vary on a plant-by-plant basis. Companies eager to build and run the facilities held out the promise to cities and towns that they would easily cover their costs. The revenue would come from "tip-

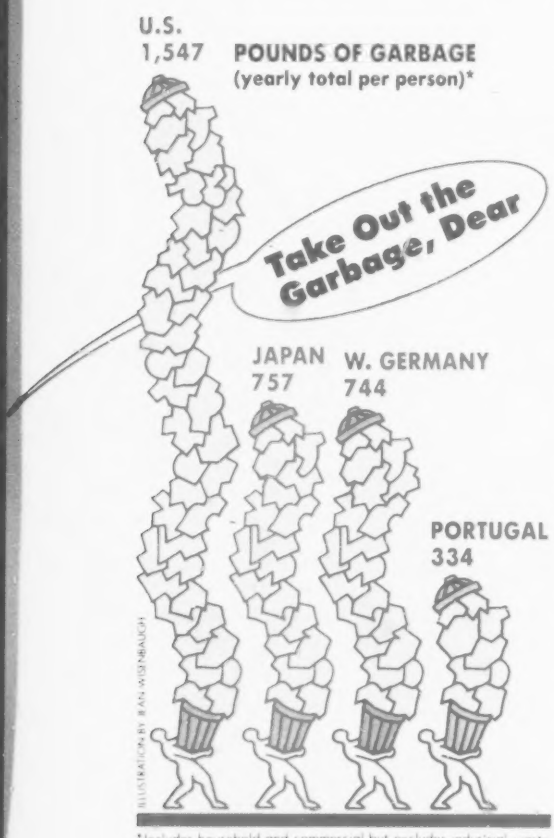


ILLUSTRATION BY JEAN WOMBAUGH

*Includes household and commercial but excludes industrial waste
SOURCE: NATIONAL SOLID WASTES MANAGEMENT ASSOCIATION

Barred from burying *ash locally, a new Vermont incinerator is sending it 70 miles away.*

KENNETH JARECKE—CONTACT

ping" fees—the amount charged per ton of trash accepted from the community—plus energy sales. For the leading companies that run them, the incinerators have generally been profitable. But mastering the technology has not been easy, and some communities have wound up with a bigger disposal bill than they had anticipated.

THOUGH MASS-BURN works efficiently in Europe, the technology is not easily transferable. U.S. trash, for one thing, burns differently because it contains more plastics and toxic materials. The employees who run U.S. incinerators have also received less training than their European counterparts.

The mass-burn industry's leading operators are Ogden Martin and Wheelabrator Environmental Systems. In the early years of Wheelabrator's first incinerator, which began operating in 1975 in Saugus, Massachusetts, the company had to replace the superheaters and redesign the burners and grates at a total cost of $11 million. "We had a lot of downtime during the early years," acknowledges public affairs director Kevin Stickney, who refers to the Saugus plant as the "University of Waste-to-Energy."

Newer plants have not yet licked all the problems. The mass-burn incinerator for the county of Tuscaloosa, Alabama, lost an average of $20,000 a month in its first 34 months of operation. When the plant wasn't running, the county couldn't honor its agreement with Uniroyal Goodrich, which had contracted to buy steam for a tire plant. In the spring of 1986, Tuscaloosa County's solid-waste disposal authority filed suit against the plant's operator, Consumat Systems of Richmond, Virginia, charging breach of contract and negligence in design and operation. In an out-of-court settlement, Consumat agreed to repair equipment at its own expense and to forgive unpaid bills in return. The tipping fee has also been raised.

Community leaders often fail to read the fine print in the deals they negotiate with incinerator companies. Many have signed "put or pay" contracts that guarantee the operator a minimum tonnage to keep the fires going. If the trash intake is below the minimum, the community pays compensation.

The local utility is required by federal law to buy electricity from the incinerator. The price per kilowatt-hour, however, can be nearly twice the utility's costs at its own power stations. If the price is challenged by regulators, the community may have to make up the lost income to the incinerator operator. Such was the experience of Rutland, Vermont, home of an embattled new incinerator built by Vicon Recovery Systems of Butler, New Jersey, and financed by the Industrial Bank of Japan.

"Vicon got its foot in the door by promising a low tipping fee of $16.50 per ton," recalls Patricia Donnelly, a Rutland alderman who was once an enthusiastic supporter of the plant. "Vicon also claimed to have a firm electric contract." Vicon notes that in 1984 Central Vermont Public Service agreed to pay 12.02 cents per kilowatt-hour for 26 years. But in 1987, when the incinerator was nearing completion at a cost of $35 million—far above the original budget—the Vermont Public Service Board vetoed the rate as excessive. "We had no choice but to go back to the utility and settle on a short-term rate of 3.06 cents until we resolved the long-term rate," says Joseph J. Domas Jr., president of Vicon. Vicon raised the tipping fee nearly threefold to make up for the lost income, to $45 a ton.

The controversy rages on in Rutland. Air pollution does not appear to be a major problem. That's because the incinerator is one of only six in the U.S. equipped, at the state's insistence, with scrubbers. Aside from innocuous steam, a spokesman boasts, emissions from the plant are less than from just one of the state's ubiquitous woodburning household stoves. The hot issue is how to get rid of the incinerator's ash.

In tiny Sunderland, 35 miles away, residents are fighting plans to inter the stuff in a landfill near the banks of the pristine Battenkill River, a treasured trout stream. Half Sunderland's adult population turned out for meetings to oppose the idea. They won the first round in court last fall when a judge ordered Vicon to stop work at the landfill site. In the meantime Vicon is trucking ash 70 miles to a landfill in Massachusetts.

Fanning the furor is the fact that, upon testing, incinerator ash often turns out to be as toxic as hazardous waste from industry, which must be buried in double-lined landfills. J. Winston Porter, assistant administrator of the U.S. Environmental Protection Agency, thinks incinerator operators should be spared the rigamarole of obtaining hazardous-waste disposal permits and that some ash requires only single-lined landfills.

Environmentalists insist that only double-lined landfills will do. In an effort to get all ash classified as hazardous in Massachusetts, they have left buckets of it on Governor Michael Dukakis's front steps. It came

NINA BARNETT

NINA BARNETT

KEN KRIER

Recycling on the Job

Doing her bit under New Jersey's recycling law, Barbara McCormick, an executive secretary at Warner-Lambert's headquarters in Morris Plains (top), puts recyclable paper in a separate basket. Employees in an AT&T warehouse (center) gather collected paper, including shredded confidential documents, and the Shannon Lounge in Hoboken (bottom) makes good use of a "bottle buster."

from an area next to a salt marsh, where Wheelabrator has been dumping for years.

Several states have passed laws requiring scrubbers on new facilities. Massachusetts has also mandated scrubbers for some older plants that lack them. Wheelabrator, which resisted this requirement, has warned that it will have to boost the tipping fee at Saugus by at least $25 a ton, to about $50, to cover the cost of a scrubber.

The EPA, criticized for dragging its feet in drafting guidelines for incinerators, is trying to catch up. "There is no question we have been behind," says Porter. The agency's new regulations are not expected to take effect before 1990, but Congress will probably act much sooner. Two pending bills would establish strict federal standards for emissions and for the handling of ash. Democratic Representative James Florio of New Jersey is the sponsor in the House; Democratic Senator Max Baucus of Montana is pushing the bills in the Senate.

Communities that fight incineration say they favor a stepped-up recycling effort first. Only then, they contend, will mass-burn be justified. That was to be the nation's agenda in the 1970s. Critics argue that cities and towns have impeded the recycling effort by putting a priority on incinerators and committing all garbage to them.

The disposal programs in land-poor Japan serve as a model for the world. According to Allen Hershkowitz, author of a book on the subject, 50% of the country's household and commercial waste is recycled, 16% goes to landfills, and the remaining 34% is incinerated. (In the U.S., 86% winds up in landfills.) In the best-run Japanese programs, residents diligently separate waste into seven categories, which are collected on different days.

SKEPTICS CONTEND that such an ambitious approach would flop in the U.S. because Americans are too lazy. Incinerator foes counter that most Americans will change their habits once they realize that recycling can add years of life to landfills and save tipping fees. In just two years, without state support, the rural town of North Stonington, Connecticut, has reduced the volume of waste that goes to the local landfill by two-thirds.

When 65-year-old Milly Zantow heard that space was running out at the town dump in North Freedom, Wisconsin, she cashed in an insurance policy and set up her own recycling center, staffed mainly with volunteer senior citizens. Zantow has just a few pieces of crude equipment—a magnet for pulling out tin cans, a baler, a glass crusher—but reprocessors who melt the stuff down take all the sorted and preprocessed materials her operation can supply.

Similar recovery programs are under way in urban areas. The low-income city of Camden, New Jersey, has one of the best in the country. Recycling authority Hershkowitz recently formed a venture called Municipal Recycling Associates in Mount Vernon, New York, to help municipalities set up programs and raise capital for startup companies that separate recyclable materials from trash.

NINA BARNETT

The disposal programs in land-poor Japan serve as a model for the world. Half the country's household and commercial waste is recycled.

Depending on the material, finding a market is not a major problem in today's economy. Peter Karter, president of Resource Recovery Systems of Old Lyme, Connecticut, has plenty of takers for his processed glass and metal. His list of clients includes Owens-Illinois, Foster-Forbes Glass, and companies such as AMG Industries, which remove the tin from steel cans so they can be melted down. Karter has two operations, but is starting new centers in Massachusetts, upstate New York, Long Island, and Manhattan to meet the demand.

Recycling has a catch: A stepped-up commitment could produce a glut of certain materials. Prices of such items as scrap iron, copper, and old newsprint are notoriously volatile. Tales abound of high-minded recycling efforts that foundered when markets dried up. As in Japan, some sort of government subsidy to scrap handlers is necessary. "The major question is whether or not the government will offer incentives," says security analyst Barry A. Mannis of Shearson Lehman Hutton.

Whatever the amount needed, Hershkowitz says, it would be far less than the alternatives facing many communities now: paying higher-than-anticipated tipping fees at incinerators or shipping unsorted trash farther into the hinterlands for burial at ever higher costs per ton.

One of the nation's most stringent recycling laws was passed last summer in New Jersey, which aims to cut by 25% the tonnage that must be disposed of. The state wants 17 incinerators built to burn the rest and end the need to export trash to Pennsylvania and beyond. Critics contend that the recycling target is too modest and that a more ambitious program would make some of those incinerators unnecessary. Many cities and towns, such as Camden and Woodbury, have already surpassed the 25% goal.

Because New Jersey county officials are required to designate just three items to recycle, incinerator foes say, the law puts an artificial limit on recycling. The typical county requires households to set aside aluminum cans, glass, and newspapers for separate curbside collection (but not magazines, whose coated papers are difficult to recycle). The inclusion of plastics and mixed paper—mainly junk mail—could divert another 60%.

Most experts agree that a combination approach is needed, giving priority to recycling and burning in that order. Deposit laws for beverage containers, which nine states have enacted, partly to curb litter, would abet the recycling effort. Industry needs to undertake a major redesign effort to cut excess packaging. The quantity thrown into the waste stream has increased 80% since 1960 and now accounts for one-third of all household trash. Items containing toxic materials should be handled separately, an idea the incinerator industry supports.

Even with maximum recycling, a lot of incinerators will be needed. Scrubbers and careful ash disposal should be made mandatory. "Companies can no longer build a plant and worry about the ash later," adds John J. Sullivan, Wheelabrator's president and chief executive officer. "We must have a 20-year guarantee for landfill space up front." Some dumping will always be necessary, but must be done under safeguards. The frontier days are over. When it comes to tossing things, at least, America has run up against limits. F